

Message Text

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PASS: TREASURY, FEDERAL RESERVE BOARD, CEA

E.O. 11652: N/A
TAGS: OECD, ECON
SUBJECT: ECONOMIC POLICY COMMITTEE/WORKING PARTY TWO:
REPORT ON MAY 18-19 MEETING

1. SUMRT: DEVELOPMENT OF MEDIUM-TE SCENARIOS TO
1985 TOOK DISTINCT TURN TOWARD ANALYSIS, MOST DELE-
GATES REQUESTED SECRETARIAT TO CONTINUE WORK ON IMPLICA-
TIONS AND CONSEQUENCES OF THREE "TRACKS" OUTLINED BY
SECRETARIAT, PAYING GREATER ATTENTION TO POLICIES NEEDED
TO MOVE FROM PRESENT "UNACCEPTABLE" PERFORMANCE TO HIGHER
TRACK. SECRETARIAT WILL SEEK TO COMPLETE TECHNICAL WORK
BY END-1978. GENERAL AGREEMENT (INCLUDING GERMANS) THAT
FASTER GROWTH DESIRABLE, WITH EQUALLY GENERAL FEELING
THAT FULL RECOVERY NOT ATTAINABLE BY 1985. DISCUSSION
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OF EXTERNAL CONSTRAINT BOGGED DOWN IN COMMENTARY ON
ELASTICITIES WHICH PREVENTED MEANINGFUL DISCUSSION OF
ROLE EXCHANGE RATES PLAY IN ADJUSTING TO DIFFERENTIAL
ECONOMIC PERFORMANCE, ALTHOUGH LATTER TOPIC SPARKED
LIVELY DEBATE IN DRAFTING REPORT TO EPC; EXTERNAL SEC-
TOR WILL BE TREATED FURTHER IN SPECIAL TECHNICAL MEETING
IN FALL. WP WELCOMED, WITHOUT MUCH SUBSTANTIVE COMMEN-

TARY, SECRETARIAT INITIATIVE TO INCORPORATE STUDY OF SPECIAL NEEDS OF LESS-INDUSTRIALIZED OECD MEMBER COUNTRIES IN MEDIUM-TERM STUDY. REPORT TO EPC, BASED ON NEW DRAFT BY SECRETARIAT AND CHAIRMAN, WAS ADOPTED; COPIES BEING HANDCARRIED TO EUR/RPE - GELBARD AND TREASURY - KLOCK BY NEXT TRAVELLER. END SUMMARY

2. REPORT TO EPC: EXTENSIVE DISCUSSION OF NEED FOR AND CONTENT OF WP MESSAGE TO EPC RESULTED IN EMERGENCE OF SEVERAL GENERALLY-AGREED THEMES:

(A) INTERIM REPORT TO EPC SHOULD BE MADE, IN PART BECAUSE OF IMPORTANCE OF UPCOMING SERIES OF MEETINGS ON INTERNATIONAL ECONOMIC SITUATION;

(B) REPORT SHOULD REFLECT STATE OF WORK TO DATE, INCLUDING AREAS OF WIDE-RANGING AGREEMENT, BUT SHOULD NOT SPECULATE ON POSSIBLE CONCLUSIONS FROM WORK STILL IN EARLY STAGES;

(C) FASTER GROWTH IS WIDELY REGARDED AS DESIRABLE, BUT EXACT PATH NOT YET DETERMINED;

(D) WP SHOULD MORE FULLY ELABORATE IMPLICATIONS AND CONSEQUENCES OF (1) CONTINUED SLOW GROWTH ("EXTENSION OF PRESENT POLICIES"), (2) PATH TO FULL RECOVERY BY LIMITED OFFICIAL USE

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1985, AND (3) A REVISED PATH WHICH TAKES ACCOUNT OF INTERNAL AND EXTERNAL CONSTRAINTS;

(E) ANALYSIS SHOULD INCLUDE MEDIUM-TERM POLICIES NECESSARY TO MOVE FROM PRESENT "COMATOSE STATE" (QUOTING THE GERMAN DELEGATE - RANZ) TO MORE DESIRABLE FASTER GROWTH.

3. SECRETARIAT'S DRAFT REPORT TO EPC (CPE/WP2(78)1) WAS CONSIDERED "TOO AMBITIOUS" BY MANY DELEGATES (INCLUDING U.S., UK, JAPAN). DELEGATES FELT THAT "LOW" (3 PERCENT GROWTH) AND "REVISED" (4-1/2 PERCENT) TRACKS WERE NOT SUFFICIENTLY ANALYTICAL AND/OR WERE BASED ON BITS OF ANALYSIS NOT ACCEPTED BY WP2. SIMILARLY, AN INITIAL ATTEMPT BY WP2 CHAIRMAN (SCHREINER, NORWAY) TO DRAFT "POLICY-ORIENTED SUMMARY" DRAWING ON SECRETARIAT'S DOCUMENT WAS REJECTED. REVISED DRAFT (FROM JOINT EFFORTS OF SECRETARIAT AND CHAIRMAN) WAS CIRCULATED ON SECOND DAY AND, AFTER LONG DRAFTING SESSION BY FULL WP, WAS ADOPTED AS WP-2 REPORT TO EPC. TEXT OF REPORT WILL BE HANDCARRIED TO WASHINGTON IN COURSE OF THIS WEEK.

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CPE/WP2(78)1 WILL NOT BE RECIRCULATED, BUT IS REFERRED
TO IN WP'S REPORT AS BASIS OF DISCUSSION.

4. DRAFTING SESSION CLEARLY REVEALED EXACT AREAS OF
DISAGREEMENT WITHIN WP. TOUGHEST NEGOTIATION INVOLVED
REFERENCES TO ADJUSTMENT TO DIFFERING ECONOMIC PERFORM-
ANCES VIA EXCHANGE RATE MOVEMENTS. JAPANESE (NISHIJIMA
OF PERMANENT DELEGATION, OBVIOUSLY UNDER STRICT INSTRUC-
TIONS) AND GERMAN DELS STRONGLY OPPOSED REFERENCES TO
"POSSIBLE NEED FOR FURTHER SUBSTANTIAL REAL EXCHANGE
RATE ADJUSTMENTS," WHILE U.S. OBJECTED TO QUALIFYING
PHRASE "IT IS RECOGNIZED THAT SCOPE FOR EXCHANGE RATE
CHANGES TO RECONCILE WIDELY DIVERGENT ECONOMIC PERFORM-
ANCE IS LIMITED." (SEE PARA. 6 FOR FURTHER ON THIS SUB-
JECT.) OTHER STICKING POINTS INCLUDED (A) SCOPE OF PUB-
LIC SECTOR DEFICITS AS MEDIUM-TERM POLICY TOOL WITH GER-
MANY AND AUSTRALIA ARGUING THAT FISCAL STIMULUS DID NOT
NECESSARILY LEAD TO RECOVERY SINCE IT MAY HAVE NEGATIVE
IMPACT ON PRIVATE SECTOR CONFIDENCE; (B) CITATION OF
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SPECIFIC 4-1/2 PERCENT GROWTH RATE AS SUSTAINABLE IN MEDIUM TERM (GERMANY, JAPAN, SWITZERLAND SUGGESTING TOO HIGH, U.S., CANADA, SWEDEN, TOO LOW). THERE WAS NO SUPPORT FOR USE OF "WORK-SHARING" AS SOLUTION TO CURRENT UNEMPLOYMENT PROBLEMS.

5. IT IS WORTH NOTING THAT THROUGHOUT DISCUSSION OF REPORT TO EPC, GERMAN DELEGATION JOINED U.S., UK, CANADA, ITALY TO STRESS NEED FOR FURTHER ANALYTICAL WORK ON IMPLICATIONS AND CONSEQUENCES OF EXTENDING PRESENT POLICIES INTO MEDIUM TERM. GERMAN DEL DESCRIBED PRESENT SITUATION AS CLEARLY UNACCEPTABLE AND URGED SECRETARIAT TO IDENTIFY POLICIES NEEDED TO GET OUT OF IT. GERMANS, FRENCH, AUSTRALIANS AND DUTCH, HOWEVER, WARNED AGAINST STRICTLY "MACRO-ECONOMIC" SOLUTIONS, EMPHASIZING NEED FOR MORE FUNDAMENTAL POLICY DESIGNED TO CHANGE ATTITUDES (E.G., TOWARD PROFITS), IMPROVE INVESTMENT CLIMATE, ENCOURAGE INNOVATION, AND BRING ABOUT STRUCTURAL AND SECTORAL ADJUSTMENT. ROLE OF PRIVATE SECTOR AS "REAL ENGINE OF GROWTH" WAS HIGHLIGHTED AND GREATER ATTENTION WAS REQUESTED TO QUESTION OF "CONFIDENCE." FRENCH DEL, SECONDED BY UK, ALSO REQUESTED SECRETARIAT TO ANALYZE POSSIBILITY THAT CAPITAL OUTFLOWS COULD SUBSTITUTE FOR ADJUSTMENT OF GROWTH RATES IN CASE OF COUNTRIES THAT MIGHT DECIDE THEY PREFERRED SLOWER GROWTH THAN OTHERS.

6. EXTERNAL CONSTRAINT TO ECONOMIC GROWTH - CPE/WP2(78)3: DISCUSSION OF EXTERNAL CONSTRAINT BOGGED DOWN IN TECHNICALITIES OF IMPORT AND EXPORT ELASTICITIES AND NEVER REALLY GOT INTO SUBSTANCE OR CONCLUSIONS. MOST DELEGATIONS WELCOMED SECRETARIAT'S EFFORTS (DESPITE QUESTIONING ELASTICITIES USED), WHILE JAPAN (FOR WHICH 20 PERCENT REAL YEN APPRECIATION WAS INDICATED) VEHEMENTLY OBJECTED TO THE PAPER AND CAUTIONED THAT "WHILE ITS BASIS WAS WEAK, ITS INFLUENCE COULD BE GREAT (IF IT GOT INTO THE WRONG HANDS)." JAPANESE DEL ARGUED THAT PAPER DID NOT SPELL OUT ITS ASSUMPTIONS OR ITS MODEL AND THEREFORE DID NOT PERMIT INFORMED COMMENTARY ON RESULTS (WHICH PARTICULARLY DEPENDENT ON BASE USED). FRENCH DEL WONDERED HOW REAL EXCHANGE RATE ADJUSTMENTS COULD BE USED AS POLICY TOOL; HOW CAN GOVERNMENT INFLUENCE REAL EXCHANGE RATE? MOST EUROPEAN DELS NOTED LARGE NOMINAL EXCHANGE RATE CHANGES NECESSARY TO GET SMALL REAL CHANGES, CITING HIGH COST IN TERMS OF DOMESTIC INFLATION. THERE WAS ALSO GENERAL SUPPORT FOR NOTION THAT STRUCTURAL ADJUSTMENT OF DOMESTIC ECONOMY WAS POWERFUL ADJUSTMENT DEVICE WHICH NEGLECTED BY SECRE-

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TARIAT LN ITS PRESENTATION EMPHASIZING DICHOTOMY OF EXCHANGE VS. GROWTH RATES. ONLY SUBSTANTIVE CONCLUSION GENERALLY ACCEPTED WAS EVIDENT PREDOMINANCE OF GROWTH RATES (I.E., INCOME EFFECT) OVER REAL EXCHANGE RATES (I.E., PRICE EFFECT) IN PROCESS OF BOP ADJUSTMENT. SEVERAL DELS REQUESTED, AND SECRETARIAT EVENTUALLY ACCEPTED, ORGANIZATION OF TECHNICAL MEETING BEFORE NEXT WP-2 MEETING TO DISCUSS IN DETAIL TECHNICAL ASPECTS OF EXTERNAL SIDE OF MEDIUM-TERM SCENARIOS.

7. GROWTH PROSPECTS OF LESS INDUSTRIALIZED OECD COUNTRIES (LIC) - CPE/WP2(78)2: SECRETARIAT NOTED ESSENTIAL DISTINCTION BETWEEN LIC'S AND OECD AS A WHOLE WAS EXISTENCE OF SUPPLY CONSTRAINT (BOTH PRODUCTIVE CAPACITY

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AND FINANCIAL) FOR LIC'S, WHEREAS OTHER OECD COUNTRIES GENERALLY FACED DEMAND INSUFFICIENCY. PECULIAR PROBLEMS OF EXCESS LABOR (ESPECIALLY RECENT CHANGE IN MIGRATION FLOWS) AND NEED FOR LARGE MEDIUM-TERM CAPITAL INFLOWS ALSO RELEVANT. LIC'S WELCOMED SECRETARIAT INITIATIVE TO IDENTIFY "SPECIAL PROBLEMS," ALTHOUGH GREECE SUGGESTED IT NOT REALLY MEMBER OF THIS GROUP. TURKISH DEL OPINED THAT OECD ANALYSIS SHOULD NOT BE SO COLDLY

OBJECTIVE, BUT SHOULD SHOW "GREATER SYMPATHY" FOR LIC'S
BY, E.G., CHANGING PARAMETERS TO THAT DC MEMBERS GIVE
UP 1/2 PERCENT OF THEIR EXPORT GROWTH TO LIC'S. DC
MEMBER DELS, AS SUGGESTED BY CHAIRMAN, COMMENTED ON
SECRETARIAT'S ANALYSIS IN TERMS OF PROBLEM COMMON TO
ALL OECD COUNTRIES, PARTICULARLY STRESSING NEED FOR
LIBERALIZED GOODS AND CAPITAL FLOWS NOW THAT LABOR
MIGRATION HAS BEEN CURTAILED, ESPECIALLY NEED FOR MORE
INDUSTRIALIZED COUNTRIES TO ACCEPT IMPORTS OF LABOR-
INTENSIVE PRODUCTS FROM LIC'S. U.S. DEL CAUTIONED
AGAINST BLIND FAITH IN LABOR-INTENSIVE INDUSTRIES TO
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MAXIMIZE EMPLOYMENT, SINCE PRODUCTIVITY GAINS MAY NOT BE
SUFFICIENT TO MEET WAGE EXPECTATIONS, RESULTING IN INFLA-
TIONARY PRESSURES.

8. FUTURE TIMETABLE AND WORK PROGRAM: SECRETARIAT PRO-
POSED TO HOLD TECHNICAL MEETING (PARA. 6 ABOVE) IN LATE
SEPTEMBER - EARLY OCTOBER, FOLLOWED BY WP-2 MEETING EARLY
IN DECEMBER TO PUT FINISHING TOUCHES ON MEDIUM-TERM
SCENARIOS BEFORE PUBLICATION, POSSIBLY IN DECEMBER OECD
"ECONOMIC OUTLOOK." WORK ON SCENARIOS WILL FULLY OCCUPY
SECRETARIAT TO END OF 1978. SECRETARIAT WAS REQUESTED
TO PROVIDE PAPER ON FUTURE WORK PROGRAM AT DECEMBER MEET-
ING. U.S. DEL SUGGESTED THAT WP-2 MIGHT UNDERTAKE TECH-
NICAL WORK ASSOCIATED WITH INITIATIVE ON POSITIVE ADJUST-
MENTS POLICIES.
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